reassigned to the appropriate operating expense account. Upon the successful conclusion of the lawsuit, the carrier must accumulate all of the deferred litigation costs and reclassify them to operating expense accounts.[28]

If the decision in the case was adverse to the carrier, management must determine whether to petition the Commission to allow recovery of the judgment amount and the deferred litigation costs. If it is determined that it is appropriate to seek recovery, costs must be incurred to prepare and document the factors in the litigation favoring recovery. The Commission staff and interested parties must expend resources evaluating and commenting on the request.[29] The Commission ultimately must decide whether recovery will be permitted. If recovery is disallowed, the carrier must determine whether to seek judicial review of the Commission's determination. If it does, carrier, Commission, and judicial resources must be expended to adjudicate the case.

At each step of the protracted proceeding described above, resources are dedicated and costs incurred that are

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[28]See BellSouth's comments regarding the proper treatment of litigation costs in cases where the triggering count is dismissed at a preliminary stage of the proceeding at page 34, <u>infra</u>.

[29]The complexity of the analysis required is indicated by the Commission's order in In Re: Alascom, Inc. Request for Ratemaking Recognition of an Antitrust Settlement, <u>Memorandum Opinion and Order</u>, DA 90-115, released February 2, 1990; <u>Memorandum Opinion and Order</u>, DA 91-179, released June 24, 1991.

wholly unnecessary in the absence of the proposed litigation cost rules. Significantly, these costs will be incurred, and paid for by ratepayers and taxpayers, without regard to the outcome of the litigation. With its limited resources, the Commission should avoid adopting rules which are so resource intensive to implement.

For example, upon adoption of the prior rule, BellSouth personnel in the legal and accounting departments held a series of meetings to develop a means of tracking litigation costs associated with target lawsuits. Necessary modifications were made to BellSouth's mechanized System for Legal Information Management to tag lawsuits subject to the Commission's rules and to track litigation costs subject to potential disallowance. Instructions were developed and circulated to the legal and accounting personnel in each of BellSouth's nine states and the appropriate headquarters organizations.

Once the systems and procedures modifications were accomplished, BellSouth legal offices were required to track all incoming and pending litigation to insure compliance with the Commission's rules. Although BellSouth did not track the time of its employees involved in this effort, an idea of the administrative burden imposed can be gleaned by considering that BellSouth has more than 1000 lawsuits pending at any given time, with about 600 new lawsuits being received and the same number of old lawsuits being resolved per year. Although the vast majority of these lawsuits are not implicated by the proposed rule, each must be examined and classified. Thus, BellSouth incurred substantial administrative costs in complying with the now vacated rules and would incur substantial administrative expenses if new litigation cost rules are adopted.[30]

By contrast, the benefit to ratepayers resulting from operation of the proposed rules can be expected to be minimal. Adverse judgments against carriers in antitrust cases are exceedingly rare. During the more than four years that the vacated rules were in effect, BellSouth did not incur a single adverse antitrust judgment or settlement that would have triggered a disallowance. Most federal statute cases are in the labor field.[31] The majority of such cases are Title VII discrimination claims. Most cases are disposed of at a preliminary stage of the litigation. Adverse judgments in such cases are rare, and do not usually involve significant sums. For example, during the applicability of the vacated rules BellSouth paid only one adverse judgment in a federal statute labor case. The

[30]BellSouth notes that after the Litton Accounting Appeal and Litigation Costs Decision were rendered, and the Commission took no action on remand for more than a year, BellSouth eliminated the tracking procedures that it previously had in place. Thus, if the Commission adopts new litigation cost rules in this proceeding, BellSouth will be forced to incur start-up costs to implement the new rules.

[31]At any given time, BellSouth has pending approximately 50 federal statute labor cases.

amount of the judgment, including plaintiff's attorney fees, was $111,000.00. Yet the substantial administrative costs identified above were incurred by the carrier and borne by ratepayers. Thus, in BellSouth's experience, no significant ratepayer benefits accrued during the four years that the vacated rules were applied, and substantial direct and indirect costs were incurred.

B. The indirect costs that will result from the adoption of the proposed rules are significant.

In addition to the direct costs caused by the proposed rules, there are significant indirect costs as well. First, to the extent that investors perceive that carriers' ability to recover their operating costs are artificially impaired by the proposed rule, the investors' risk, and hence required return, will increase. In addition, to the extent that the Commission requires deferred recovery of litigation costs, investors will be forced to supply additional operating capital to the carrier. This will result in increased cash working capital requirements.

More significantly, if the proposed rules require that regulated carriers forego aggressive competition in order to avoid potential disallowances, ratepayers will surely be the loser. Emerging competitors will clearly target the most profitable markets of the existing carriers. Such markets produce revenues that exceed avoidable costs. To the extent that these competitors are successful, not because of their business acumen but because the Commission's proposed litigation cost rules dull carrier incentives to compete aggressively, the remaining ratepayers of the carrier will be harmed.

The Commission's failure to consider the incentive impact of the prior litigation cost rules on carrier management was cited by both panels of the Court of Appeals as grounds for reversal.[32] Yet the Notice contains no analysis of the impact of the proposed rules on carriers. BellSouth respectfully submits that the adverse impact of the proposed rules, both directly in the form of higher costs to ratepayers, and indirectly in the form of adverse incentives for carrier management, far outweigh any perceived ratepayer benefit that may result from disallowed expenses.

In addition to the incentive impact on the carriers, the Commission should also consider the incentives that the proposed rule would create for a carrier's competitors. The proposed rules provide an incentive for competitors to engage in litigation rather than legitimate competition. Not only can successful antitrust litigation result in a potential windfall for a competitor, through the provision for treble damages and the recovery of attorney's fees, but the competitor will also realize that it can inflict damage on the carrier through the arbitrary deferral and

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[32]See Litton Accounting Appeal, 939 F.2d at 1034; Litigation Costs Decision, 939 F.2d at 1046-47.

disallowance of operating costs. Since most competitors are also customers of the carrier, they can realize a double benefit from antitrust litigation: first from possible damages and second from the deferral and possible disallowance of carrier costs.

As the Court found in the Litton Accounting Appeal:

> Antitrust suits frequently present a multitude of complex issues, many of which may be intertwined with esoteric economic concepts in a legal context where precedents and clear standards may be hard to come by. Serious strategy planning may at best be difficult, and under the Commission's regimen may be well-nigh impossible.[33]

Competitors who are unsuccessful in the marketplace already have ample incentives to attempt to recoup their competitive losses in the courts. The Commission should not adopt rules that add to the incentives for carriers' competitors to litigate.

The Commission should recognize that carrier management is not going to engage in a willful violation of the antitrust laws, with or without the proposed rules. But if the Commission's pro-competitive policies are to produce the maximum benefit for ratepayers, carriers must compete aggressively with emerging competitors. To dull the competitive drive of the incumbent carriers by imposing draconian sanctions if decisions made now in good faith are found later to have violated shifting antitrust standards

[33]Litton Accounting Appeal, 939 F.2d at 1034.

will do far more harm to ratepayers than any perceived benefit from the proposed rules.

## V. The proposed accounting for antitrust judgments is inappropriate.

The Commission justifies its proposed disallowance of adverse antitrust judgments with a single, unsupported hypothesis: "activity which leads to an adverse antitrust judgment, anticompetitive behavior, 'rarely, if ever, produces any benefit for ratepayers'".[34] This simplistic hypothesis assumes that there is a bright line between procompetitive and anticompetitive behavior that should be apparent to carrier management at the time decisions are made and conduct initiated. In the real world, that is almost never the case. A specific, historical example will highlight the difficulty facing management in making such determinations.

When MCI sought to enter the interexchange market, the Commission initially authorized MCI to offer only private line service, not ordinary message telephone service ("MTS"). When MCI offered an MTS equivalent service, Execunet, the Commission ordered MCI to discontinue the service.[35] On review, the Court of Appeals held in Execunet I that until the Commission held hearings and made the appropriate findings, MCI's authorization could not be

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[34] Notice at para. 9.

[35] MCI Telecommunications Corp., 60 FCC 2d 25 (1976).

limited to private line services, and MCI was free to offer any service it chose.[36] After the Supreme Court denied certiorari in Execunet I, AT&T sought from the Commission a declaratory ruling that the Bell Operating Companies had "no present obligation" to provide MCI with additional interconnections to expand Execunet service. The Commission so ruled.[37] In Execunet II, the Court of Appeals reversed the declaratory ruling.[38] In each case, the Bell Operating Companies followed the Commission's Orders as they were issued. Nevertheless, their interconnection policy ultimately formed the basis for a finding of antitrust liability against the Bell System.

MCI had filed an antitrust lawsuit against the Bell System in 1974 alleging monopolization of intercity communications. The case ultimately was tried in 1980. A jury awarded MCI damages based, among other counts, on the Bell System's interconnection practices. MCI alleged that the Commission's 1971 Specialized Common Carriers[39] decision

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[36] MCI Telecommunications Corp. v. Federal Communications Commission, 561 F.2d 365 (D.C. Cir. 1977), cert. den., 434 U.S. 1040 (1978) ("Execunet I").

[37] American Telephone and Telegraph Co., 67 FCC 2d 1455 (1978).

[38] MCI Telecommunications Corp. v. FCC, 580 F.2d 590 (D.C. Cir. 1978), cert. den., 439 U.S. 980 (1978) ("Execunet II").

[39] Establishment of Policies and Procedures for Consideration of Application to Provide Specialized Common Carrier Services, 29 FCC 2d 870 (1971) ("Specialized Common Carriers").

established a broad policy favoring carrier interconnection. Although the Seventh Circuit characterized the Commission's Specialized Common Carriers decision as "extremely opaque", it upheld the jury verdict on the grounds that both the FCC and the Courts had subsequently interpreted that ruling to require interconnection.[40]

Thus, antitrust liability was found based on conduct that was not only undertaken by management in reliance on its good faith interpretation of the law, but also which was expressly condoned by the Commission at the time the conduct occurred.

The vagaries of antitrust litigation are highlighted by the fact that in another antitrust lawsuit decided at about the same time and containing charges comparable to those made by MCI, the District of Columbia Circuit declined to find liability against the Bell System based on its interconnection policy. The Court upheld the Bell System's reliance on its interpretation of Specialized Common Carriers, finding that Bell had a "reasonable basis in regulatory policy" to believe that it was not required to interconnect after Specialized Common Carriers.[41] In that case, antitrust liability was rejected.

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[40]MCI v. AT&T, 708 F.2d 1081, 1133-36 (7th Cir. 1983).

[41]Southern Pacific Comm. Co. v. AT&T, 740 F.2d 980, 1010 (D.C. Cir. 1984), cert. denied, 470 U.S. 1005 (1985). See also Mid-Texas Comm. Systems, Inc. v. AT&T, 615 F.2d 1372 (5th Cir. 1980), cert. denied, 449 U.S. 912 (1980).

This example simply highlights that there is no bright line test for management to follow in determining whether, with 20-20 hindsight, a course of conduct will be determined to be lawful or anticompetitive by an antitrust jury or appellate court. An antitrust jury evaluates conduct that occurred years previously in the context of its experience at the time of trial. The facts upon which its decision is based are filtered by the laws of evidence and the adversarial process. It is precisely because of such uncertainty that the jurisprudence does not impute a presumption of imprudent management conduct based solely on the outcome of litigation.[42] The Commission should abandon its tentative conclusion that the outcome of litigation should determine whether litigation costs should be included in ratemaking.

The Notice proposes to amend the rules to require that carriers record adverse antitrust judgments in Account 7370, Special Charges. Such accounting will result in presumptive below-the-line treatment of these costs in ratemaking. The Notice states that a "carrier would be permitted to argue, in the ratemaking process, that a particular judgment should be included in its revenue requirement."[43] However, the Notice does not explain when and how such a showing would be made, nor the standard the Commission would use to evaluate

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[42]See, e.g., Appalachian Electric and Ditmars, supra.

[43]Notice at para. 10.

such a showing. If the Commission decides to adopt its proposed accounting change, it should specify in the rules when the carrier should make such a filing (annual access tariff filing or separate waiver request) and the standard that the Commission will use to evaluate whether a carrier has overcome the presumption of disallowance. In the absence of such specificity, it may be expected that substantial resources of both the carriers and the Commission will be expended in litigating these issues on a case-by-case basis.

VI. The proposed distinction between pre- and post-judgment antitrust settlements should be rejected.

In the Notice, the Commission proposes to require that carriers record antitrust settlements in Account 7370, a below the line account.[44] BellSouth opposes this treatment for the same reasons that it opposes the proposed treatment of antitrust judgments, above.

In addition, the proposal to treat the fact of settlement as establishing a presumption of disallowance of the settlement amount is contrary to established law and public policy. In Reply Comments filed in the Commission's prior rulemaking on this issue, CC Docket No. 85-64, the Section of Antitrust Law of the American Bar Association supplied a comprehensive review of the jurisprudence and public policy considerations favoring settlement of

[44] Notice at para. 11.

antitrust litigation. The Section of Antitrust Law concluded:

> In sum, to treat a settlement as an adverse judgment for purposes of considering whether to assess costs in below-the-line accounting would have a chilling effect on the settlement of antitrust cases and would be contrary to the public policy which favors compromise to avoid wasteful litigation and associated expenses.[45]

Since the Commission's prior rulemaking, Congress has enacted, and the Commission has embraced, the Alternate Dispute Resolution Act ("ADRA"). The ADRA is a direct statement of Congressional policy favoring settlement of disputes. The Commission's proposal to disallow settlement costs is directly contrary to the ADRA and the policy it advances. The Commission should allow settlement amounts, whether pre- or post-judgment, as reasonable operating expenses.

The Commission also seeks comment on whether a carrier presumptively should be allowed to recover the "nuisance value" of a lawsuit if a settlement is achieved prior to a judgment.[46] If the Commission adopts its proposed

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[45]In the Matter of Notice of Proposed Rulemaking to Amend Part 31 Uniform System of Accounts for Class A and Class B Telephone Carriers to Account for Judgments and Other Costs Associated With Antitrust Lawsuits, and Conforming Amendments to Annual Report Form M, CC Docket No. 85-64, Reply Comments of the Section of Antitrust Law of the American Bar Association, filed July 15, 1985, at page 7.

[46]Notice at para. 12. "Nuisance value" is not defined in the Notice. If the Commission adopts this proposal, it should define "nuisance value" in the Rules. BellSouth suggests that "nuisance value" be defined as "The estimated incremental cost of litigation and counsel fees that would

presumptive disallowance of antitrust settlements, it should permit recovery of the incremental litigation costs and counsel fees that are avoided by the settlement. This treatment is consistent with congressional policy articulated in the ADRA, which the Commission has incorporated into its Rules. The proposed treatment of avoided litigation costs will provide carriers with at least some incentive to avoid the cost of protracted litigation that the Commission's presumptive disallowance policy creates.

In the Notice, the Commission tentatively concludes that "nuisance value" recovery should be allowed only in the case of prejudgment settlements.[47] BellSouth opposes this distinction. The entry of an adverse judgment is simply one factor which a carrier must evaluate in determining whether to settle an antitrust lawsuit. The carrier must still weigh the costs of continuing the litigation against the probability of success on appeal.

The Section of Antitrust Law of the American Bar Association strongly opposed any rule that drew a distinction between pre- and post-judgment settlements:

> An appeal from a judgment in a United States District Court is a matter of right, 28 U.S.C. Sec. 1291. Many of the same considerations which impel settlement at the trial level are also relevant to compromise at the appeal level, and

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be avoided by the settlement."

[47]Notice at paras. 14-15.

again no adverse inference can be drawn from the fact of settlement per se.[48]

Under the Commission's proposed rules, a carrier that has received an adverse judgment must record the amount of that judgment, or the amount of the proposed settlement, below the line. This treatment provides a carrier with a strong incentive to continue the litigation if it feels it has a reasonable probability of obtaining a reversal on appeal. Permitting the carrier to recover the additional litigation costs avoided by the proposed settlement will provide at least some offsetting incentive to settle. This will restore at least some balance to the incentives that a carrier would face in the absence of the Commission's presumptive disallowance rule.

VII. The Commission's proposed deferral accounting for other antitrust litigation expenses is unduly onerous.

The Notice proposes that other antitrust litigation costs be recorded in a balance sheet deferral account until the entry of a final, non-appealable order or settlement in the underlying lawsuit.[49] The Commission suggests that deferral accounting addresses the concerns expressed by the Court in the Litigation Costs Decision that the prior "recapture" method constitutes retroactive ratemaking.

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[48]See CC Docket No. 85-64, supra, Reply Comments of the Section of Antitrust Law Section of the American Bar Association at 7.

[49]Notice at paras. 17-19.

BellSouth opposes the disallowance of other antitrust litigation costs based on an adverse outcome or post-judgment settlement in the underlying lawsuit. As BellSouth has demonstrated above, under settled jurisprudence, management's decision to litigate an alleged antitrust violation is not rendered imprudent simply because the outcome of the case may be unfavorable.[50]

Even if the Commission continues to tie recovery of other litigation costs to the outcome of an antitrust lawsuit, BellSouth opposes the proposed deferral accounting method. This method is even more onerous to the carriers than the prior "recapture" method because it requires that investors bear the full cost of litigation, without recovery in regulated rates, throughout the duration of the lawsuit.

In the Notice, the Commission asserts that the proposed deferral method holds "antitrust litigation expenses entirely outside the ratemaking process until it can be determined whether the expenses are allowable or not."[51] This presumes that there is some cost free source of funds that carriers can use to finance protracted litigation. This presumption is totally unrealistic. Since the Commission's Part 65 rules specify which accounts are included in the calculation of net income and rate base, and

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[50]See Appalachian Power, supra; Ditmars, supra; Litton Accounting Appeal, supra.

[51]Notice at para. 18.

Account 1439 is not included in these calculations, recording these costs in a balance sheet deferral account effectively acts as a disallowance of these costs during the pendency of the litigation. If these costs are not recovered in regulated rates during the pendency of the litigation, they must be financed by investor supplied capital.

If the Commission wishes to use deferral accounting for antitrust litigation expenses for the price cap LECs, BellSouth recommends that the Commission follow one of two methods: either include the balance in Account 1439 in rate base during the pendency of the litigation and then charge the principal balance to operating expenses upon the successful termination of the litigation (or deduct the balance from rate base upon the unsuccessful termination of the proceeding); or, upon the successful termination of the litigation, permit the carrier to charge to operating expenses the principal amount deferred plus interest capitalized daily at the carrier's earned rate of return.

Either of these methods strikes a more reasonable balance between ratepayers and investors interests than the method proposed in the Notice, because these methods makes the investor whole for advancing operating capital that should be recovered as operating expenses as they are incurred. It should be noted, however, that even these methods defer the recovery of prudently incurred expenses, thereby increasing shareholder risk and hence the carrier's cost of capital. BellSouth therefore recommends that the Commission make no change in the present accounting or ratemaking treatment of antitrust litigation costs.

Finally, if the Commission adopts deferral accounting, it should not require that litigation costs be deferred until entry of a final, non-appealable order or settlement in the underlying lawsuit. Frequently, antitrust counts are added to "garden variety" lawsuits that are wholly unwarranted by the facts. Carriers are frequently able to have such counts dismissed at a preliminary stage of the proceeding. Once such counts are dismissed, there is no basis for continuing to defer litigation costs during the pendency of the underlying lawsuit. The Commission should permit reclassification of the deferred litigation costs to operating expense accounts at the time the counts that triggered deferred accounting are eliminated from the lawsuit.

## VIII. If the Commission adopts its antitrust litigation rules, those rules should not be extended to other types of statutory violations.

In CC Docket No. 85-64, the Commission extended its analysis of the antitrust laws to all violations of federal statutes. In the Litigation Costs Decision, the Court of Appeals reversed, holding that extending the Commission's antitrust analysis to all federal statutes "is neither self-evident . . . nor bolstered by either analytical or empirical support."[52] In the Notice, the Commission quotes, in part, a hypothetical case posited by the Court of Appeals in which carrier management elects a course of conduct that, if ruled lawful, would save expenses, but if ruled unlawful, would result in an adverse judgment, and in which the chance of losing is 10 percent.[53] However, the Notice deletes the Court's rationale for finding the course of conduct selected by the carrier's management reasonable:

> It would be misleading to say that requiring ratepayers to bear the cost of the resulting judgment, if any, causes them to subsidize the carrier's illegal activity. The carrier made the "right" decision, i.e., what the ratepayers would have decided in their own economic self-interest; it just turned out to be the "wrong" decision as a matter of how the law was finally interpreted. Perhaps the agency has a more capacious notion of ratepayer benefit than merely paying lower rates. If it does, however, it has neither said as much nor indicated why ratepayers are generally harmed in some non-economic way by the violation of federal statutes.[54]

In the Notice, the Commission proposes to extend the proposed rules to "state antitrust lawsuits" and to "lawsuits involving violation of federal statutes in which the actions giving rise to the lawsuit did not benefit ratepayers."[55] The Commission asks parties favoring such an extension of the rule to provide "a list of other federal

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[52]Litigation Costs Decision, 939 F.2d at 1044.

[53]Notice at para. 20.

[54]Litigation Costs Decision, 939 F.2d at 1045.

[55]Notice at paras. 21-22.

statutes for which it can be assumed that actions in violation of the statute did not benefit ratepayers."[56] The way the Notice formulates the issue totally misses the point of the Court of Appeals' example. It was not the particular federal statute which was involved that was significant to the Court. It was the reasonableness of the carrier's conduct, viewed in the context facing the carrier when it made the specific decision involved, that determined whether that conduct was reasonable. In the Court's example, carrier management made a "right" decision that "benefited ratepayers" i.e., was the decision that ratepayers would have made in their own economic self-interest, that just turned "wrong" when adjudicated after the fact. For the Commission to compile a list of federal statutes, the violation of which may be presumed not to "benefit ratepayers" is an exercise in futility. The Commission should not attempt to extend its presumptive disallowance policy beyond antitrust cases, but should analyze carrier conduct in other cases under the present rules, and disallow expenses only if they are shown to be imprudent or inefficient.

## IX. The interim accounting rule adopted in the Notice is patently unlawful, and must be withdrawn.

In the Notice, the Commission adopted interim action requiring

[56] Notice at para. 25.

> carriers to record any antitrust judgments and settlements incurred during this interim period in account 1439, deferred charges. Upon completion of this rulemaking, carriers would then be allowed to treat these expenses in accordance with the new rules.

This requirement is unsupported in the Notice and is patently unlawful. Section 220(g) of the Communications Act states, in pertinent part:

> Notice of alterations by the Commission in the required manner of keeping accounts shall be given to such persons by the Commission at least six months before the same are to take effect.

Pursuant to Section 220(g), the earliest date that a change in accounting for antitrust judgments and settlements can be imposed is six months following the effective date of a final order to that effect in this proceeding.

The interim rule is also unlawful because it will result in retroactive rulemaking in violation of the Administrative Procedures Act.[57] It would also be a violation of the prohibition against retroactive ratemaking to apply rules proposed in this proceeding to costs incurred prior to the completion of the rulemaking.[58]

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[57] See Bowen v. Georgetown University Hospital, 488 U.S. 204 (1988). See also the definition of "rule" in the Administrative Procedures Act, 5 U.S.C.A. Sec. 551(4), which limits rules to agency statements having "future effect" and which constitute prescriptions "for the future". The APA definition limits rules to prospective, not retroactive, application, at least in the absence of direct Congressional authorization for retroactive rulemaking. See Justice Scalia's concurring opinion in Bowen, supra.

[58] Bennett v. New Jersey, 470 U.S. 632, 639-40 (1985); Greene v. United States, 376 U.S. 149, 160 (1964); Rodulfa v. United States, 461 F.2d 1240, 1247 (D.C. Cir. 1972).

The Commission should immediately rescind the instructions given to carriers in the Notice regarding interim accounting rules for antitrust judgments and settlements.

X. Conclusion.

The proposed rules are counterproductive. Their adoption will cause carriers to incur unnecessary costs and will penalize conduct undertaken prudently and in good faith. They will provide no net benefit to ratepayers. The Commission should reconsider the tentative conclusions reached in the Notice, and should decide, based on the record, that the existing accounting and ratemaking rules for litigation costs are in the public interest.

The interim rule adopted by the Commission in the Notice is patently unlawful, and must be set aside immediately. The Communications Act and the Commission rules require that carriers be given six months notice of changes in accounting standards. If the proposed rules are adopted, they can only take effect six months after the effective date of the order. To order otherwise violates the prohibitions against retroactive rulemaking and retroactive ratemaking.

Respectfully submitted:

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